Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1995

THE PACIFIC LUMBER COMPANY; MAXXAM GROUP, INC.; MAXXAM INC.; CHARLES HURWITZ; PAUL N. SCHWARTZ; JAMES IACO; WILLIAM LEONE,
Petitioners,

vs.

CLARENCE KAYES; GENE KENNEDY; SHARON KENNEDY; WILEY LACY; JOHN R. MAURER; LESTER REYNOLDS; SHIRLEY REYNOLDS; HOLLIS ROLLINS; DONALD FILBY; JACK MILLER; JAMES LOVELL; PAUL S. BRADY; WILFRED A. BLAIN; LLOYD S. TUCKER; DONALD J. SCHOENHOFER,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONERS' REPLY BRIEF

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INTRODUCTION[1]

Respondents seek to divert the Court's attention from the importance and ripeness of the questions presented by arguing that the questions are not properly presented by the record below and that, even if they were, they will not recur. Respondents are mistaken.

A. The Ninth Circuit's Erroneous Assumption Of Jurisdiction Over Respondents' Prohibited Transaction Claim Could Not Be Waived

Respondents argue that the Ninth Circuit did not decide whether respondents had standing to assert their prohibited transaction claim and hence whether the court had subject matter jurisdiction to entertain their appeal from summary judgment on that claim.[2] If respondents are right, the Ninth Circuit disobeyed this Court's requirement that federal courts *must* decide their own jurisdiction even if the parties have not raised the question, because subject matter jurisdiction cannot be waived either by the parties or by a federal court. *FW/PBS, Inc. v. Dallas,* 493 U.S. 215, 230-31, 110 S. Ct. 596, 607-08, 107 L. Ed. 2d 603, 621-22 (1990). Respondents, not petitioners, had the burden of establishing facts upon which subject matter jurisdiction depended, *id.* at 231, and they did not do so.

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[1] Pursuant to Rule 29.1, petitioners state that the statement of corporate affiliation set forth in footnote one of The Petition For A Writ Of Certiorari filed in this matter is accurate, and by this reference incorporate that statement herein.

[2] If respondents were correct that the lower court did not decide its own jurisdiction, it necessarily follows that the court's discussion of the prohibited transaction issue is *dicta* and that the district court on remand would not be foreclosed by the law of the case doctrine to decide its own jurisdiction and, if jurisdiction were determined to exist, to decide the merits *de novo.*

Congress narrowly circumscribed federal jurisdiction to decide ERISA cases by defining those persons who are authorized to bring suit, the subject matter of such suits, and the relief that federal courts are permitted to give. This Court has been explicit that federal courts are not permitted to expand their jurisdictional reach by broadening the definition of persons who are entitled to bring such actions, by extending the remedies that are available under the statute, or by inferring claims for relief that Congress has not specifically authorized. *E.g., Mertens v. Hewitt Assocs.*, 508 U.S. ____, 113 S. Ct. 2063, 2068 n.5, 124 L. Ed. 2d 161, 169 n.5 (1993) (the question is "whether the statute affirmatively *authorizes* such a suit" [emphasis in original]); *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 117, 109 S. Ct. 948, 958, 103 L. Ed. 2d 80, 97 (1989) ("To say that a 'participant' is any person who claims to be one begs the question . . . and renders the definition set forth in § 1002(7) superfluous."); *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 105 S. Ct. 3085, 87 L. Ed. 2d 96 (1985).

Before enactment of the Pension Annuitants Protection Act of 1994 ("PAPA"), Pub. L. No. 103-401 (Oct. 22, 1994), former beneficiaries or participants of terminated plans were held to be without standing to maintain ERISA claims because they were neither "participants" nor "beneficiaries" of a plan within the meaning of the statute. *E.g., Firestone Tire*, 489 U.S. at 117-18 (to be a "participant" within the meaning of ERISA, employees who are not in currently covered employment must have a "colorable claim" that they may become eligible for benefits in the future); *Raymond v. Mobil Oil Corp.*, 983 F.2d 1528, 1532-36 (10th Cir.), *cert. denied*, 114 S. Ct. 81, 126 L. Ed. 2d 49 (1993); *Winchester v. Pension Comm. of Michael Reese Health Plan, Inc.*, 942 F.2d 1190, 1192-93 (7th Cir. 1991); *Teagardener v. Republic-Franklin, Inc., Pension Plan*, 909 F.2d 947, 952-54 (6th Cir. 1990), *cert. denied*,

498 U.S. 1027, 111 S. Ct. 678, 112 L. Ed. 2d 670 (1991);[3] *Kuntz v. Reese,* 785 F.2d 1410, 1411 (9th Cir.) (per curiam), *cert. denied,* 479 U.S. 916, 107 S. Ct. 318, 93 L. Ed. 2d 291 (1986); *Yancy v. American Petrofina, Inc.,* 768 F.2d 707, 708 (5th Cir. 1985); *Saladino v. ILGWU Nat'l Retirement Fund,* 754 F.2d 473, 476 (2nd Cir. 1985).

PAPA extended standing only to former participants or beneficiaries of a terminated plan and only to seek assurance that they would receive full benefits from an insurance contract purchased by the plan sponsor to pay the benefits of the terminated plan. Respondents' prohibited transaction claim attacking Pacific Lumber's pledge of its future interest in a potential reversion of surplus assets after plan termination is not a suit for benefits within the meaning of PAPA nor within the meaning of ERISA before PAPA was enacted.[4]

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[3]Since its decision in *Teagardener,* the Sixth Circuit has created its own exception to the rule that only "participants" have standing to sue under ERISA section 502(a). *See Swinney v. General Motors,* 46 F.3d 512, 518-19 (6th Cir. 1995). *Swinney,* relied upon by respondents, held that a fiduciary cannot "defeat an employee's standing to bring an ERISA action by duping him into giving up his right to participate in a plan. ERISA should not be construed to permit the fiduciary to circumvent his ERISA-imposed fiduciary duty in this manner." *Id.* The "but-for" standing test articulated by the Sixth Circuit in *Swinney* has been applied in the First, Second and Fifth Circuits, albeit with varying factual requirements to meet the "but-for" link, but it has been rejected by the Fourth, Ninth and Tenth Circuits. *See id.* and cases cited therein.

The *Swinney* rule is inapplicable to respondents' claims because there is no allegation (nor could there be) that termination of the Pacific Lumber plan, which ended respondents' participant status, was a breach of fiduciary duty. Even if *Swinney* were applicable, it is yet another example of a sharply defined, acknowledged split among the circuits and would only provide further reason for the Court to grant the Petition.

[4]Respondents' reliance on statements from the floor of the House as legislative history of PAPA, Opp. Brief at 9-10, is misplaced. Unless the language of a statute is shown to be ambiguous, the Court has eschewed

Respondents' contention that the jurisdictional question presented will not recur because Congress has amended the tax law to impose heavy excise taxes on reversions of surplus assets to corporate plan sponsors after a plan has terminated is simply wrong.[5] The unarticulated premise is that the Ninth Circuit's decision applies *only* when the sponsor of a plan pledges its future interest in connection with a corporate takeover. However, the court's rationale cannot be thus limited because the magic that retroactively turned Pacific Lumber's asset into an asset of the Plan was Pacific Lumber's intention to use its own asset in a way that did not benefit the Plan. Under the Ninth Circuit's analysis, a pledge of a plan sponsor's future interest in the reversion becomes a plan asset whether that asset is pledged to refinance a company's existing debt, to build a new plant, or to do any other act that does not benefit the plan. The statutory availability of legal fees in ERISA provides sufficient incentive to lawyers for beneficiaries or former beneficiaries of ERISA plans to challenge any use that a plan

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reference to legislative history. If the legislative history must be consulted, "the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill," not statements by individual members. *Garcia v. United States*, 469 U.S. 70, 76, 105 S. Ct. 479, 483, 83 L. Ed. 2d 472, 478 (1984).

[5] Indeed, respondents factual assertions about the nature of the tax — supposedly potentially "50 percent" — are wrong as well. As respondents deign to explain in a cryptic footnote, an excise tax of 10% was already in place when Pacific Lumber terminated its plan. The tax was increased in 1988 to its current level of 20% for termination/restart transactions like the Pacific Lumber termination. *See* Internal Revenue Code § 4980, enacted effective January 1, 1986 by the Tax Reform Act of 1986, Pub. L. No. 99-514, *amended by* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508. Moreover, the budget bill currently pending before Congress would remove the excise tax altogether for the next five years, in order to free up surplus assets for use by corporate sponsors. Revenue Reconciliation Act of 1995, Subtitle F, § 13607, approved by House Ways & Means Committee Sept. 19, 1995.

sponsor may have made or intended to make of its future reversionary interest in excess ERISA plan assets. While there have been instances in which ERISA plans have been underfunded, it is no secret that billions of dollars of surplus exists in many others. It cannot reasonably be doubted that the Ninth Circuit's decision, if uncorrected, will generate even more ERISA litigation.

B. A Sponsor's Future Interest In Surplus Assets, If Any, Of A Terminated Plan Is Not A Plan Asset And Cannot Be Used To Change A Legitimate Use Into A Prohibited Transaction

Respondents' arguments wrongly assume that Congress designed ERISA's fiduciary provisions to be a prophylactic against corporate takeovers, friendly or otherwise. The purpose in enacting ERISA was to provide reasonable assurance to beneficiaries of ERISA plans that their vested retirement benefits will be paid. Nothing in the legislative history of the prohibited transaction rules remotely suggests that the drafters were concerned about corporate takeovers or were attempting to discourage such takeovers through ERISA. *See H.R. Rep. No. 533,* 93rd Cong., 2d Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4651, 4655; *S. Rep. No. 127,* 93rd Cong., 2d Sess. (1973), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4866-69.

Respondents' reliance on *Commissioner v. Keystone Consol. Indus.,* 508 U.S. ____, 113 S. Ct. 2006, 124 L. Ed. 2d 71 (1993) is misplaced. That was a tax case in which this Court observed that Congress intended to bar a transaction that was likely to injure a pension plan. In this case, however, as the lower court recognized, the pledge of the sponsor's future interest was designed so that by definition it could not injure the Plan because the pledgee would not "be able in any way to reach [P]lan assets." App. 36.

Respondents' citation of *John Hancock Ins. Co. v. Harris Trust & Sav. Bank,* 114 S. Ct. 517, 126 L. Ed. 2d 524 (1993), for the proposition that "this Court has adopted a broad definition of 'plan assets'," Opp. Brief at 13, similarly misses the mark. In *Harris Trust,* the Court considered whether insurance companies managing pension plan assets under "general account contracts" fit within a statutory exemption to the rule that anyone who manages plan assets is an ERISA fiduciary. *See* ERISA § 401(b)(2), 29 U.S.C. § 1101(b)(2). The *Harris Trust* Court did not, as respondents assert, base its analysis on a holding that the term "plan assets" should be broadly construed. Rather, after noting that the term "plan assets" is not defined in ERISA, this Court held that Congress had clearly intended the statutory exemption at issue to be construed narrowly (all parties agreed that if the exemption did not apply the assets were plan assets). *Harris Trust,* 114 S. Ct. at 524-25.

Respondents' argument that Pacific Lumber's future interest was a Plan asset when the pledge of that asset was given to the lender is based on a serious misconception of the law of future interests. A future interest is a present asset of its owner, but the future interest does not become a present interest in the property until interests precedent have ended. Restatement of Property § 153, cmt. (e) (1936). To use a familiar analogy, a daughter who will receive the reversion in the family home in which her parents have retained a life estate has a future interest in that property; she can pledge her interest as collateral to secure a loan for her own benefit. Although the present value of her future interest may be difficult to determine, it cannot be doubted that it is she, not her parents, who owns the reversion.

The same is true here. The Plan could never have owned either a future interest in the reversion or the reversion itself. There would be *no* reversion if the Plan owned it because

the present and future interests would merge, extinguishing the future interest. The reversion does not "fall in" until all liabilities of the Plan have been discharged and the Plan is dead.

Congress in ERISA could have forbidden a plan sponsor from making any use of its future interest in surplus plan assets, but it did not do so. Section 406 is explicit that a transaction cannot be a prohibited transaction unless it involves some kind of dealing with the "assets of the plan." Because the Plan never owned the future interest, Pacific Lumber's pledge of its asset could not constitute a prohibited transaction unless the Ninth Circuit was free to rewrite both the statute itself and settled property law. The federal courts are not permitted to revise ERISA, particularly if their purpose is to attempt to give protection to pensioners that Congress did not believe necessary. *Mertens,* 113 S. Ct. at 2071-72.

C. ERISA's Functional Definition Of Plan Fiduciaries Is Not A Substitute For Evidence That Petitioners Acted As Plan Fiduciaries

Respondents argue the fiduciary status point as if petitioners were contending that persons who are officers or directors of a plan sponsor cannot also be fiduciaries of a plan. Of course they can — if there is substantial evidence that they went sufficiently beyond their duties as directors or officers so as to exercise personal control and authority over a plan. Such evidence was not produced here. The question whether petitioners Hurwitz and Leone became Plan fiduciaries by virtue of their individual actions was never tried. The only evidence on the question was submitted in support of respondents' motion for summary judgment that these two petitioners were Plan fiduciaries. The district court granted summary judgment on the ground that they were Plan

fiduciaries as a matter of law, and the Court of Appeals affirmed.

All the record shows is that petitioners Hurwitz and Leone (like other officers of Pacific Lumber who were not sued) collected information regarding various insurance companies and annuity options, participated in discussions at meetings of the board of directors with respect to those providers, and voted as board members on the ultimate selection. Petitioners have not alleged that Pacific Lumber's information-gathering or discussion process constituted a breach of fiduciary duty. They challenge the selection decision. And there is no question that Hurwitz and Leone (along with a third board member) voted on the selection *in their capacity as members of Pacific Lumber's Board of Directors.* On this record, petitioners Hurwitz and Leone were in the same situation as those persons charged with being fiduciaries of an ERISA plan in *Confer v. Custom Eng'g Co.,* 952 F.2d 34 (3d Cir. 1991) who were held to be non-fiduciaries under Section 3(21)(A) of ERISA.

The "functional test" of fiduciary status cited by respondents cannot be applied in a vacuum, as a matter of law. It is necessarily fact intensive, and it cannot be met where, as here, the only "individual" act of "control" over the Plan's assets in the record was the casting of a vote as a member of the board of directors of a plan sponsor. To hold otherwise would gut not only the functional test, but the very concept

that entities as well as individuals can be fiduciaries of ERISA plans.

Dated: September 27, 1995.

Respectfully submitted,

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